

Message Text

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ACTION EA-14

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C O N F I D E N T I A L HONG KONG 10594

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TAGS: EFIN, HK

SUBJECT: HONG KONG USES ITS RESERVES

SUMMARY: THE ACTING FINANCIAL SECRETARY ANNOUNCED THAT THE BUDEGTARY DEFICIT IN THE CURRENT FINANCIAL YEAR IS LARGER THAN EXPECTED AND THE HKG HAS BEEN DRAWING DOWN RESERVES TO FINANCE IT. WHILE RESERVES ARE STILL HIGH AND THE DRAWDOWN IS NOT EXPECTED TO BE MASSIVE, IT WILL BOLSTER THE ARGUMENTS OF THOSE HKG OFFICIALS WHO WISH TO SEE A PRONOUNCED DELAY IN LARGE PUBLIC WORKS EXPENDITURES. END SUMMARY.

1. LIKE THE PROVERBIAL NEW ENGLAND WIDOW WHO OCCASIONALLY RESORTS TO PROSTITUTION RATHER THAN DIP INTO HER CAPITAL, THE HKG HAS BEEN VERY JEALOUS OF ITS RESERVES AND RELUCTANT TO SPEND THEM. THE YIELD ON RESERVES IS AN IMPORTANT SOURCE OF REVENUE (AN ESTIMATED HK\$360 MILLION IN THE CURRENT YEAR) AND THE RESERVES HAVE TRADITIONALLY BEEN PUBLICLY PRESENTED AS HONG KONG'S SAVINGS FOR A RAINY DAY. A NUMBER OF LOCAL CRITICS HAVE MAINTAINED THAT THE RAINY DAY IS HERE (HK 8371) AND BRINGING BACK THE RESERVES HAS BEEN A SHIBBOLETH OF THE NEW LEFT HERE.

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2. ON SEPTEMBER 20, THE HKG PUBLISHED ACCOUNTS FOR JUNE

WHICH SHOWED A DEFICIT OF HK\$100 MILLION AND A FIRST QUARTER (THE FINANCIAL YEAR BEGINS APRIL 1) DEFICIT OF HK\$282 MILLION VS. A \$10 MILLION SURPLUS FOR THE SAME PERIOD OF 1973. THE SEPTEMBER FNCB ECONOMIC LETTER SAYS THAT THE ACCUMULATED FISCAL SURPLUS FELL BY 9.7 PERCENT TO HK\$2.7 BILLION BETWEEN APRIL 1973 AND APRIL 1974. ON SEPTEMBER 23, THE ACTING FINANCIAL SECRETARY, DEREK JONES, SAID IN AN INTERVIEW, THAT THE HKG HAS BEEN DRAWING DOWN DEPOSITS FROM LOCAL BANKS TO MEET THE "UNEXPECTED DEFICIT." HE TOOK PAINS TO POINT OUT THAT GILT-EDGED SECURITIES IN LONDON WERE UNTOUCHED. HE DECLINED TO SPECULATE WHETHER THE DEFICIT WILL PERSIST BUT SAID THAT IF IT DOES, THE RESERVES WILL SEE HONG KONG THROUGH THE REST OF THE FINANCIAL YEAR.

3. COMMENT: HONG KONG HAS HAD ONLY TWO DEFICIT YEARS SINCE WW II. THIS LOSS OF MOMENTUM IN ACCUMULATING RESERVES COMES AT A TIME WHEN HONG KONG HAS A LONG LIST OF SCHEDULED PUBLIC WORKS PROJECTS (HK A-238). THERE HAS BEEN CONSIDERABLE SPECULATION THAT HONG KONG COULD NOT FINANCE THESE FROM RECURRENT REVENUE AND WOULD BE FORCED TO BORROW, IF NOT AGAINST THE RESERVES DIRECTLY, AGAINST GUARANTEES ULTIMATELY BACKED BY THE RESERVES. THE CURRENT TIGHT INTERNATIONAL CAPITAL MARKET ALREADY DICTATES PRUDENCE IN SUCH BORROWING BUT THERE IS A CONSIDERABLE BODY OF HKG OFFICIALS WHO ARE OPPOSED TO GREATLY EXPANDING CAPITAL EXPENDITURES. DWINDLING RESERVES PROVIDE READY AMMUNITION FOR THIS GROUP. ON THE OTHER HAND, THERE IS A FORWARD-LOOKING GROUP (WHICH INCLUDES THE GOVERNOR) WHO FEEL THAT THE TIMING OF INFRASTRUCTURE PROJECTS IS CRUCIAL TO THE CONTINUED VIABILITY OF HONG KONG. THE PUBLIC WORKS SCHEDULE WILL, THEREFORE, BE THE SUBJECT OF A LIVELY, IF NOT NECESSARILY PUBLIC, DEBATE WITHIN THE HKG THIS YEAR.

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